The Theory of Inflation

By
Henry Carey Baird

10

Baird, H. C.

THE THEORY OF INFLATION.

A Critical Examination of a Ruinous Popular Fallacy.

Reprinted from the Philadelphia EVENING TELEGRAPH of November 8, 1873.

To the Editor of the Evening Telegraph:—

More than a century ago David Hume published his *Essay on Money*, which consists of a succession of brilliant but disjointed thoughts, part truths, part fallacies, so intermingled, and so plainly inconsistent one with another, that the reader is at times at a loss to know whether the author be a believer in the advantages of a constant, an increasing, or a decreasing volume of money in any community or country. However, the so-called principles, the assumed-to-be truths of the contractionist are derived from this very source, which is the real and original fountain-head of this contractionist's monetary philosophy. This philosophy has but little even to-day to offer us which is not drawn from Hume, and in the main it is but the carrying out to its logical conclusion of a single one of his leading propositions.

Senator Sherman, for instance, deeply imbued with this one doctrine, has in an official paper committed himself in the fullest manner to it and its consequences, and from him we may learn to what extent these consequences go. In reference to the reissue of the so-called "reserve" of $44,000,000, Mr. Sherman, in a report of the Senate Finance Committee, January, 1873, said that "the full exercise of such a power would undoubtedly affect the nominal value of all property in the United States to the extent of at least 10 per cent., and the real value or burden as between debtor and creditor at least 10 per cent. on all contracts to be performed *in futuro*."

Let us now see how this would work in actual practice. The value of all the property in the United States in 1870 was $30,000,000,000, so its increase by 10 per cent would add to it $3,000,000,000. Can any more extraordinary assumption well be imagined, than that $44,000,000 of currency should have the power to add to the value of the existing

property of this country $3,000,000,000, or over sixty-eight times its own volume?

From what observation of facts, and by what form and manner of reasoning, can this conclusion be arrived at? Why, first by the gratuitous assumption of Hume, that the prices of all things in any country, at any and at all times, are fixed as they so stand in that country "by the proportion between commodities and money" in that country, and then, further, by the easy step that any increase of money, without an increase of commodities, must increase prices in exact proportion.

But if prices depend solely upon "the proportion between commodities and money," how is it that with but $750,000,000 of currency in this country, we find $30,000,000,000 of commodities and other property? According to the dictum of the school, we should look for and find but $750,000,000. It will not do to tell us that this money circulates, and thereby gives value to $30,000,000,000 of commodities and other property. This is not in harmony, but in direct conflict with the teachings of the school. With it money is, as it were, but an inert, lifeless mass, possessing what may be termed *statical*, but not *dynamical* qualities--a mere yardstick or dead-weight, which by its own simple and single length or ponderosity, acts as an inflexible, unyielding determiner of the value of the total mass of the commodities in a country. To tell us that it circulates, and thus has a new power, a new function, a new office, is to change the very terms of the proposition. But even if this new factor be thus dragged in, it must be on the necessary condition that at all times, and in all places, and among all peoples, money circulates at a given and constant rate of velocity. There can be no possible escape from this necessity. Upon which horn of the dilemma then, will the contractionist hang—that of asserting of money that it possesses no life-giving property, or that, while possessing such power, that power always and everywhere acts with equal force? One or the other he must take, and each is equally opposed to experience as well as to common sense.

But, further, with his inflexible effect of the "proportion between commodities and money," the disciple of Hume is forced into the additional and necessary logical position of maintaining that no increased amount in the production of commodities, by the application of steam and machinery; by the subjugation of new lands to the control of man, or the improvement of the old ones; by the discoveries of science, or by the arts of civilization; by the increase of population or of intelligence; even be the results such as to give a yield of ten, twenty, or fifty fold, as compared with that of the past, can add one dollar to the

aggregate value of those commodities unless accompanied by an increase of currency! Will even our American contractionist seriously maintain a proposition so utterly absurd, so notoriously false?

Let us now inquire what are the real forces at work in governing prices? They are—the quantities of the commodities, the cost of reproduction, the number of the persons desiring to possess such commodities, and the means at the command of such persons towards such possession. Hence we find that in all countries almost exclusively engaged in agriculture, the prices of agricultural products and of labor are low. There being but few persons not engaged in agriculture, there can be but a limited demand for its products, and for the same reason—an absence of a diversified industry—there is but a feeble societary life, and but little demand for labor. And here we instance India, in which have been mined for perhaps twenty centuries, and into which have flowed from abroad for a century, in a large and of late years, in an immense volume, the precious metals. These phenomena are accompanied, too, by low prices for labor and for almost every native product. Here it is evident that the distribution of the precious metals is so unequal that, while vast in amount, these metals give purchasing power to but few. It is clear then that in India, at least, the great principle of "inflation" does not work! Real principles work uniformly, each in its own manner and form, while false ones do not; and here is an unfailing touchstone by which to test the truth of any and all such claiming to be real and true ones. That of inflation, when thus tried, is found wanting.

The cost of reproduction of manufactured articles is comparatively low in all countries in which a diversified industry has been developed to a high degree, and in which labor-saving machinery takes the place of the labor of unaided human hands. Into such countries—into Germany, France, and Belgium, for instance—the precious metals have for many years flowed in one continuous stream, and have there accumulated, while labor has risen in value, by reason of the increased demand for it; but the prices of manufactured products have largely fallen, because of the increasing power of steam and machinery. Manufactured goods flow out of these countries, in an ever-increasing volume, to lands which have not developed their industries, and in which labor is low, and which export their precious metals. Surely, Germany, France, and Belgium, with their immense acquisitions of the precious metals, and each with the addition of a large circulation of notes, do not present a single fact going to support the theory of inflation.

In the number of persons in a country desiring to possess, by purchase, commodities the productions of their own countrymen, we have

an almost unerring measure of the diversification of employments in that country, for the greater the differences the greater and the more rapid will be the intercourse and the demand for such commodities. But here the money question only enters so far as that money succeeds in quickening societary life into vigorous and healthful action. The function here exhibited is not that of the mere yardstick or the pound weight, but is closely analogous to that of the blood that courses freely through the veins and arteries of the healthy animal organism. In such a state we have not alone consumption, but production, the two constituting a happy and a harmonious balance of forces—an exhibition of phenomena entirely the reverse of the discords so confidently held by the disciples of Hume. During the late War of the Rebellion this balance was greatly disturbed by the abstraction of a large number of able-bodied men from production, and by the enormous demands of the government for subsistence, clothing, and the materials of war generally. From this cause and from excessive taxation—a measure, in part, of the demands of the government for commodities—prices rapidly advanced, and yet the schoolman could see nothing in these results but an evidence of the truth of his delusion—inflation.

Having seen that prices cannot be governed by "the proportion between commodities and money," but that they are largely dependent upon the quantities of commodities, the cost of reproduction, and the number of persons desiring to possess such commodities; let us now inquire how the means at the command of such persons towards such possession affect prices and how far it is possible, by legislative enactment, to keep those means from the possession and control of the people.

The general and wide dissemination of wealth among a people must exert a strong influence towards advancing prices among such people so far as consumption alone can do it, by increasing the body of consumers; while, on the contrary, an equal amount of wealth concentrated in the hands of a few will exert less influence in that direction, for the reason that while these favored ones may live in luxury, the many may hardly be able to command the mere necessaries of life, and the great aggregate of consumption be thus limited. These two conditions are well illustrated, the first in the United States, and the last in Great Britain. However, even the effect of a large measure of consumption is to result in a conteracting one—production, which may and often does check any advance in prices.

Now let us see how far a State can, by legislative enactment, so interpose its fiat as to succeed in preventing its people from purchasing

and consuming, or holding for speculative ends, such commodities as they are bent on having—for this is really the question before us, once that we have disposed of the theory that prices depend upon "the proportion between commodities and money." Our illustrations and examples shall be taken from Great Britain. That country has, for a century or more, in its financial affairs, been completely under the control of men of the school of Hume, and during the latter half of this period she has maintained so-called specie payments. There, where every effort has been made to carry out the system, may we look for the ripened fruit of it. In England all notes under £5 have been interdicted, and it has only been by reason of her native pluck and energy that Scotland has been enabled to obtain and retain them, after more than one severe contest.

A recent intelligent English writer on finance and banking estimates

The gold and silver in circulation in Great Britain at	£70,000,000	$339,500,000
The circulation of the Bank of England, Oct. 16, 1872, was	34,328,708	166,500,000
The notes in circulation in the United Kingdom, other than those of the Bank of England, September, 1872, were as follows:—England, £5,057,910; Scotland, £5,313,560; Ireland, £7,242,081	17,613,551	85,425,000
Total		$591,425,000

Here we have in less than $600,000,000, the circulating medium expressly provided by the government for its people, either by its own coinage or through those institutions which it has permitted to issue circulating notes. But is this medium, with its capacity for vital work, a full measure of the purchasing power at the command of the people of Great Britain? Has the Englishman been content to feel that here are the monetary instruments placed at his disposal by his Parliament and sovereign, and that with these alone and none others shall he work? By no means!

R. H. I. Palgrave, Esq, a recent able writer and statistician, in a paper read before the Statistical Society of London, of which he is a member, declares upon data admitted to be sound, that the deposits of the British banks amount to £584,000,000, or nearly $2,900,000,000. The same writer, in his *Notes on Banking*, from a very careful analysis of the sales of stamps for bills payable for a series of years, estimates the average amount of bills in existence at any one time in 1870–71 as follows:—

Inland or domestic bills . . .	£210,850,000	
Foreign bills drawn on England . .	30,700,000	
	£241,550,000	over $1,200,000,000

If, then, we consider the extent to which the credit system is carried in private transactions in England, and especially the enormous accounts run up by the nobility and gentry, we shall have no difficulty in arriving at the conclusion that the amount of always existing debts, for which no notes or bills of exchange are given, is at least equal to that of those for which they are given. If this be the case, we have:

Bank deposits	$2,900,000,000
Bills of exchange	1,200,000,000
Private or other debts for which no bills are given	1,200,000,000
	$5,300,000,000

$5,300,000,000 of purchasing power—nine times the volume of the currency of the country—almost wholly the result of the use of credit. By the aid of bank checks and clearing houses, this credit system is maintained with the smallest possible allowance of bank notes and specie—Mr. Palgrave placing the bank reserve of all Great Britain as low as four (4) per cent., $116,000,000, while the daily average clearings of the London Clearing House alone are nearly $100,000,000. The bank deposits, almost wholly the creation of the banks, through the loan of their credit, are, for all purposes of buying for consumption, trade, and speculation, as efficient and as active as circulating notes. The bills of exchange and private debt-charges lack the activity of circulating notes and bank deposits, but are permanent and constant representatives of the power of purchase, until a crisis comes to contract their volumes.

If these, then, be the results of repressive monetary legislation in the home of David Hume, and in the land in which his doctrines have so long reigned supreme, is it not entirely evident that all legislative attempts to control the trading and speculation of an active, enterprising, intelligent, and free people, by imposing an arbitrary limit to the amount of their circulating medium are utterly futile? Is it not even worse than this; for does not such legislation, while depriving those people of the power to deal for cash, force them to resort to the various forms of credit—at once the forerunner of financial crises and the food on which those crises feed? But, further, does not this particular system look somewhat like *inflation run mad*, and is not the fact that under it all commodities are not dearer in Great Britain than in every other country

in the world evidence conclusive against the soundness of the contractionist's great theory?

Let any one for a moment consider what would be the practical results to England if its people had permitted themselves to be limited in their operations by the $600,000,000 of circulating medium furnished to them by or through their government. The prosecution of her immense manufactures and foreign trade would be an utter impossibility, and it would be entirely out of her power to negotiate the large loans to foreigners, which are paid for by her exports of manufactured goods, and *the permanent carrying of which loans is only possible by reason of the existence of this large volume of bank and other credits.* Nevertheless, this system of credit, which has grown out of persistent, long continued, and vicious legislation in regard to money, is top-heavy and essentially unsound and dangerous, and liable to topple over at any and at all times. During the war of the rebellion, through our ample supply of currency and our great business activity, we were enabled to carry almost our entire government indebtedness, and it was not until peace came, and with it contraction of that currency, that it became necessary to seek foreign aid. Before that contraction commenced our people were more free from debt, in proportion to the volume of business, than at any previous period in our history. All this is, alas! now most sadly changed.

The circulation of the Bank of France, October, 1873, was nearly $600,000,000, and although specie payments have been suspended since September, 1870, gold and silver there circulate freely, the premium being but about ½ per cent., and there cannot be less than $700,000,000 of those metals in the country. The private deposits in the bank were less than $45,000,000, and business is at all times largely done for real cash. In Germany a very similar state of things exists.

Let Congress, then, as in duty bound, dismiss from its thoughts at once, and forever, any belief in the fallacy which Hume has given to the world, that prices are fixed "by the proportion between commodities and money," and in the sad delusion that it is in the power of any legislative body, in fixing an arbitrary limit to the circulating medium of a people like our own, or the English, to put a limit to their business transactions. When once they shall have so far cleared their mental perceptions, they will be prepared to give us *a full supply of national paper money having the feature of interchangeability (at the option of the holder) with government bonds bearing a fixed rate of interest.* In such interchangeability there is "a subtle principle that will regulate the movements of finance and commerce as accurately as the motion of the steam-engine is regu-

lated by its governor," and thus protect the people and the State from the dangers incident to all arbitrary empirical limiting of the circulating medium—in regard to the requisite volume of which, no *a priori* judgment can enable any man or body of men to decide upon and fix correctly. When once we are freed from the practice of such empiricism, then shall we have financial stability and security against those terrible crises which have so often visited Great Britain and the United States, the two countries, of all Christendom, the most completely under the domination of the fallacies of inflation, and of the power of legislative bodies to limit and control the business operations of a people. Then shall we have prosperity, happiness, and real peace, and forever rid ourselves of that element in our system which, by creating panics and crises, is the most potent in making the rich richer and the poor poorer.

HENRY CAREY BAIRD.

PHILADELPHIA, November 7, 1873.